

# ANALYSIS OF ORIGINAL BILL

## Franchise Tax Board

Author: Perata Analyst: Roger Lackey Bill Number: SB 71X  
Related Bills: See Legislative History Telephone: 845-3627 Introduced Date: April 17, 2001  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Power Generation System Credit Or Depreciation Deduction or Sales or Use Tax Credit or Sales or Use Tax Exemption

### SUMMARY

This bill would provide taxpayers with certain alternative tax benefits with respect to power generation systems:

- Allow a credit for a percentage of the cost to purchase or lease and to install a power generation system.
- Allow a taxpayer to depreciate a power generation system over five years.
- Exempt the purchase of a power generation system from the sales or use tax.
- Allow a retailer to claim a sales or use tax credit equal to the income tax credit described above.

This analysis will address the sales or use tax exemption, the sales or use tax credit for retailers, and the Government Code provisions establishing a Tax Allocation Committee only as they impact the department. This analysis will not address the bill's provisions in the Public Resources Code, Public Utilities Code, or Water Code as they do not impact the department or state income tax revenues.

### PURPOSE OF THE BILL

According to the author's staff the purpose of this bill is to reduce the demand on the state's power grid during peak hours.

### EFFECTIVE/OPERATIVE DATE

This bill, as a bill of a special session, would be effective on the 91<sup>st</sup> day after adjournment of the special session. This bill specifies the credits and special depreciation sections would be operative for taxable years beginning on or after January 1, 2001, and before January 1, 2006.

### POSITION

Pending.

#### Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

#### Department Director

#### Date

Alan Hunter for GHG

06/18/01

## ANALYSIS

### FEDERAL/STATE LAW

#### Credit Discussion

**Federal law** currently provides two energy-related credits: an energy investment credit, which is a portion of the investment credit, and a business credit for the production of electricity from certain renewable resources.

The energy investment credit is equal to 10% of the basis of energy property placed in service during the taxable year. Energy property includes equipment that uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat. It also includes equipment that produces, distributes, or uses energy derived from geothermal deposits. The equipment also must meet performance and quality standards prescribed by federal regulations.

The business credit provides a tax benefit for the production of electricity from certain renewable resources. It is equal to 1.5 cents multiplied by the kilowatt-hours produced by the taxpayer's qualified energy resource facility. To qualify for the credit, energy is required to be sold by the taxpayer to an unrelated person during the taxable year. Qualified energy resources include wind, closed-loop biomass, and poultry waste.

**Former state law** provided a credit under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL) equal to 10% of the cost of a solar energy system installed on premises located in California and used for commercial purposes. The credit was available for years beginning on or after January 1, 1990, and before January 1, 1994.

The credit provisions defined "solar energy system" as solar thermal electric and photovoltaic systems, but did not include devices that produced electricity through wind energy or energy conservation measures.

The former solar energy credit is further discussed in "Program Background" below.

**Current state law** does not provide any type of energy credit.

#### Depreciation Discussion

Current state and federal laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business. However, expenses for purchasing property with a useful life in excess of a year must be capitalized and depreciated over the recovery period of the property rather than deducted in the year purchased.

### THIS BILL

#### Tax Allocation Committee

This bill would establish the Tax Allocation Committee (Committee) within the Treasurer's office, consisting of the Director of Finance, the Treasurer, and the Controller. The Committee would allocate the respective benefit to each qualified taxpayer, in accordance with an unspecified allocation plan.

The aggregate amount of benefits allowed by this bill (other than the accelerated depreciation deduction) would not exceed \$50 million each calendar year.

This bill would give the Committee the authority to promulgate rules, regulations, and procedures to carry out the allocation of the credit.

Also, the Committee would report annually to the Legislature regarding the utilization of the tax incentives allowed by this bill and the activities of the Committee in relation to those incentives.

#### Power Generation Systems Purchase or Lease Credit

This bill would allow a taxpayer to make an irrevocable election to claim a credit for the costs paid or incurred to purchase or lease and install a power generation system on property located in California for the production of electricity used onsite.

The power generation system credit would be in lieu of any other credit, exemption, or deduction allowed by this bill. No deduction otherwise authorized would be allowed for any cost for which a credit was allowed.

The applicable percentage of the costs subject to the credit would be:

- 30% for any solar energy, wind-driven, or photovoltaic power generation system,
- 25% for any power generation system placed in service on or after January 1, 2001, and on or before September 1, 2001, and
- 20% for any other power generation system.

“Qualified taxpayer” would mean any taxpayer that purchases or leases and installs in this state a qualified power generation system as an alternative means of supplying its power needs in this state.

“Qualified cost” would mean any cost paid or incurred on or after January 1, 2001, and before January 1, 2006, that satisfies the following requirements:

- Is for the purchase or lease of a qualified power generation system that is certified by the Energy Resources Conservation and Development Commission and placed in service in this state.
- Is an amount properly chargeable to the capital account of the taxpayer.
- Is an amount for which the qualified taxpayer has not elected to claim the enhanced cost recovery deduction or is not an amount for which the taxpayer filed with the BOE a claim for refund in connection with the sales tax credit provided by this bill.

“Qualified power generation system” means devices either newly installed or converted from a preexisting power generation system. The system must be used for the individual function of producing electricity at the rate of 50 megawatts or less per day. A “power generation system” includes any solar energy, wind-driven, fuel cell, microturbine, photovoltaic, and natural gas generation system. “Power generation system” does not include any diesel, oil, gasoline, or steam generation system.

This bill also would define “solar energy system,” “wind-driven system,” “fuel cell system,” “microturbine system,” “photovoltaic system,” “natural gas generation system,” “steam generation system,” “compliance period,” “peak load hours,” and “placed in service.”

This bill would provide special rules in the case of a true or operating lease of a power generation system. For these leases, only the taxpayer-lessee that uses the qualified power generation system in its business activity would be allowed to claim the credit. The earlier of inception date of the lease or the date the lessee becomes unconditionally obligated to pay lease payments would be considered the “placed in service” date, and any non-capital costs (interest factor, maintenance, etc.) would be excluded from the qualified costs used to determine the credit.

This bill would require that 80% of the electricity used by the taxpayer during any taxable year within the compliance period (generally the first 60 months after the generator is placed in service) be generated by the power generation system. The bill contains a special rule for calculating the 80% requirement in taxable years that are less than 12 months and for any period during which the qualified power generation system suffers significant operational problems that limit its ability to generate electricity during a taxable year.

If the taxpayer fails to meet the 80% requirement, the taxpayer would be required to recapture a calculated portion of the credit. The recapture would be calculated based on the number of months remaining in the 60-month compliance period.

This bill would require the taxpayer to obtain and retain written certification from the state Energy Resources Conservation and Development Commission that the system is a qualified power generation system.

The Tax Allocation Committee is required to allocate to each taxpayer the amount of the credit allowed under the provision.

This bill would allow any excess credit to be carried over and used in the following six taxable years.

#### Power Generation System Depreciation Election

This bill would allow the taxpayer to make an irrevocable election to depreciate the power generation system over five years using the straight-line method of depreciation. This special depreciation deduction would be in lieu of the qualified power generation system credit, or the sales or use tax credit for retailers that file with BOE. The qualified taxpayer would still be required to meet the same requirements of the qualified power generation system credit. If the qualified taxpayer failed to meet those requirements, the qualified taxpayer would be required to recapture the difference between the accelerated special depreciation method and the normal depreciation deduction allowed for a power generation system.

The special depreciation deduction would be in lieu of any other credit or exemption allowed by this bill.

### Sales or Use Tax Credit for Retailers

This bill would allow a taxpayer to make an irrevocable election to claim a sales or use tax credit for retailers required to file a sales and use tax return with the BOE. The credit, allocated by the Tax Allocation Committee, would be equal to the power generation system credit. The credit would only be allowed if the retailer paid sales tax reimbursement or use tax for the purchase or lease of the power generation system.

The sales or use tax credit would be in lieu of any other credit, exemption, or deduction allowed by this bill.

This bill would require the taxpayer to include copies of income tax returns for the years the qualified power generation system credit was allowed.

The BOE would be required to provide an annual listing to Franchise Tax Board of retailers that claimed the credit.

### IMPLEMENTATION CONCERNS

The bill contemplates allocation of various tax benefits (other than accelerated depreciation deductions) by the Tax Allocation Committee in accordance with an unspecified allocation plan. Since the bill establishes the Tax Allocation Committee, there may be a significant period of delay prior to any allocation of tax benefits by the Committee.

For the power generation systems purchase or lease credit, it is not clear how it would be determined if a power generation system generates at least 80% of the electricity used by the taxpayer, if the power is generated only for onsite usage of the taxpayer, and if that electricity is being used during peak load hours.

### TECHNICAL CONSIDERATIONS

This bill copies the language from AB 27X, including references to a claim for refund that was eliminated from that bill. Amendments 1, 2, and 3 would eliminate the refund reference.

### **LEGISLATIVE HISTORY**

AB 27X (Koretz and Horton, 2001/2002) is identical to this bill. AB 27X was in Assembly Appropriations Committee when the First Extraordinary Session concluded. AB 1124 (Koretz, 2001/2002) is the regular session version of AB 27X, however, the bill does not reflect the exact language as the current AB 27X. AB 1124 is currently in Assembly Revenue and Taxation.

### **PROGRAM BACKGROUND**

For taxable years 1990 through 1993, state law allowed a tax credit of 10% of the cost of a solar energy system installed on premises used for commercial purposes that were located in California and owned or leased by the taxpayer. The credit could not be claimed for any solar energy system with a generating capacity in excess of 30 megawatts for any taxable year unless the federal government provided at least a 10% federal credit for that solar energy system.

For 1987-1988 state law allowed a credit of 12% of the cost of commercial solar energy systems installed on commercial premises, cooperatives, apartment buildings, or other similar multiple dwellings, including buildings and any other common areas of a condominium maintained by a homeowners' association.

From 1976-1988 state law allowed the solar energy tax credit for personal and commercial premises. The credit was refundable until 1981 and was significantly modified several times. The credit was allowed as a percentage of the purchase and installation costs of solar energy systems on premises owned by the taxpayer. For 1981 and later years, any unused credit could be carried over to succeeding years.

In 1987, the percentages allowed for the solar energy tax credit were 10% of the eligible costs for single-family dwellings, not to exceed a credit of \$1,000. For commercial property the percentage was 25% of the eligible costs. However, only 15% of the eligible costs were allowed in that year for wind energy systems installed on or after January 1, 1986, and on or before June 30, 1987.

## **OTHER STATES' INFORMATION**

*Massachusetts:* Currently has an energy credit that is equal to 15% of the net expenditures or \$1,000, whichever is less.

*New York:* For personal income tax (PIT) only, *New York* allows a credit for solar generating equipment equal to 25% of certain solar generating expenditures. The credit is capped at \$3,700 per system.

*Michigan:* Does not allow a credit, but exempts the value of energy conservation devices from the local property tax.

*Oregon:* Currently has two energy credits: a PIT consumer energy purchases credit, and a corporate tax credit for the costs of energy projects. The consumer energy purchases credit allows various credits ranging from \$50 to \$1,500 for consumer purchases of certain items. The corporate credit for the costs of energy projects is a credit equal to 35% of the incremental costs of the project involving energy conservation and other related projects.

## **FISCAL IMPACT**

This bill would not significantly impact the department's costs.

## **ECONOMIC IMPACT**

### Tax Revenue Estimate

Based on the discussion below, it is projected that all of the annual dollar amount (\$50 million) would be allocated each year.

### Tax Revenue Discussion

The impact of this bill would depend upon the number of taxpayers and businesses incurring qualifying electric power generation expenses and the average credit applied against tax liabilities.

Despite low levels of solar and other electrical use currently by taxpayers and businesses, this bill is expected to have a significant incentive effect. Qualifying electric power generation systems can range significantly. For this analysis the following data and assumptions were used:

- An average cost of approximately \$13,200 for 2001 was used (net of special rebate programs) for a solar energy system installed on single-family homes.
- 1% of all homes will install a solar energy system by 2006.
- An average cost of approximately \$143,000 for 2001 was used (net of special rebate programs) for mid-size systems between 10 kilowatts and 200 kilowatts.
- Average costs were not reduced by allowable federal credits.
- Projected volumes for mid-size systems were based on the California Energy Commission's projected rebate program.
- Assumed in aggregate that 100 megawatts for large systems would be achieved annually after the first full year of implementation.
- Assumed that all other systems would represent approximately 10% of solar systems.
- Assumed in aggregate recapture of credits would not exceed 10% of original claims.
- Adjustments were made to account for offsetting tax effects of deductions for depreciation that would be otherwise allowed under current law.

### **LEGISLATIVE STAFF CONTACT**

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO SB 71X  
As Introduced April 17, 2001

AMENDMENT 1

On page 7, line 40, strikeout "filed a claim for refund" and insert:  
claimed a credit

AMENDMENT 2

On page 15, line 8, strikeout "filed a claim for refund" and insert:  
claimed a credit

AMENDMENT 3

On page 21, strikeout lines 33 and 34, and insert:  
Section 23684 or Section 6902.3, any exemption allowed under Section 6367.5, or  
any deduction otherwise allowed by this part for any qualified